INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

August 22, 2002

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CASE MIS No.: TAM-140448-01/CC:PSI:B9

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No:
Date of Death:
Date of Conference:

LEGEND:

Decedent	=
Will	=
Foundation	=
Country	=
State	=
$x	=
$y	=
$z	=
$a	=
Year 1	=
Year 2	=
Year 3	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=

Date 5 =

Date 6 =

Date 7 =

ISSUES:

1. Does Decedent's residuary bequest to Foundation, located in Country, qualify for the estate tax charitable deduction under § 2055(a) of the Internal Revenue Code?

2. Did Decedent's lifetime transfers to Foundation constitute adjusted taxable gifts to Foundation or its directors as individuals?

3. Do the distributions from Decedent's estate to Foundation in accordance with the residuary bequest in Decedent's Will qualify for an income tax charitable deduction under § 642?

CONCLUSIONS:

1. The residuary bequest from Decedent's estate to Foundation qualifies for the estate tax charitable deduction under § 2055(a).

2. Decedent's lifetime transfers to Foundation did not constitute adjusted taxable gifts to Foundation or its directors.

3. The distributions from Decedent's estate to Foundation qualify for an income tax charitable deduction under § 642.

FACTS:

During his life, Decedent, a United States citizen residing in State, created Foundation in Country. The document establishing Foundation was executed on Date 1. Decedent was not an officer or member of the Board of Directors of Foundation.

Although Foundation's governing instrument indicates that Foundation's exclusive purpose is to provide scholarships to art students, Foundation's governing instrument did not include certain provisions required by § 508(e). In addition, Foundation did not file an Application for Recognition of Exemption (Form 1023) with the Internal Revenue Service.

During his lifetime, Decedent gave $x to Foundation. Decedent did not file a gift tax return or claim an income tax deduction in connection with the lifetime distributions.

In Year 1, Decedent executed a Will. The Will provides that the residue of Decedent's estate is to pass to Foundation.

Article Seven of Decedent's Will provides:

> In creating [Foundation] it was my intent that its purposes be exclusively charitable and educational within the meaning of section 2055(a)(2) or (3) of the Internal Revenue Code of 1986, as amended, and be restricted to promoting the arts, including awarding scholarships to [Country's] and American citizens pursuing careers in the arts. I direct that the Board of Directors of [Foundation] upon my death take any actions deemed necessary to be in compliance with section 2055(a)(2) or (3).

The Will did not include any alternative dispositions for the residue in the event of the failure of the bequest to Foundation.

Decedent died on Date 2. The residue of Decedent's estate consisted of a cooperative apartment that was sold after Decedent's death, cash or cash equivalents, and publicly traded securities, all located within the United States.

On Date 3, Decedent's estate timely filed its United States Estate (and Generation-Skipping Transfer) Tax Return (Form 706). On the return, Decedent's estate claimed an estate tax charitable deduction under § 2055(a) of $y for the entire value of the residue that was to pass to Foundation.

Decedent's estate tax return was examined by the Internal Revenue Service and the amount claimed for the estate tax charitable deduction was disallowed because the Foundation's governing instrument failed to include provisions required by § 508(e).

On Date 4, the estate filed its U.S. Income Tax Return for Estates and Trusts (Form 1041) for Year 2. On the return, the estate claimed an income tax charitable deduction under § 642 in the amount of $z. Apart from the distributions of income ($a total) to Foundation made by the estate and the distributions by Decedent during his lifetime, no further amounts have been given to Foundation from any other source.

On Date 5, Foundation's governing instrument was amended to include provisions in compliance with § 508(e). On Date 6, Foundation filed a Form 1023 Application for Recognition of Exemption under § 501(c)(3) as a private foundation, and requested relief under § 301.9100-3 of the Procedure and Administration Regulations from the filing deadline imposed by § 508 of the Code. On Date 7, the Service issued a

ruling letter recognizing the Foundation's exemption under § 501(c)(3) as a private foundation and granting the requested relief under § 301.9100-3 of the regulations. The ruling letter grants Foundation's request for an extension of the period allowed for filing of the notice required under § 508(a) and § 1.508-1(a)(2) of the Income Tax Regulations and concludes that Foundation's exemption under § 501(c)(3) is effective beginning on the date that Foundation was organized. The ruling letter also states that Foundation is a private foundation within the meaning of § 509(a).

LAW AND ANALYSIS:

ISSUE 1:

Section 2055(a)(2) provides, in relevant part, that the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises, or transfers to or for the use of any corporation or association organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), and the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, which is not disqualified for tax exemption under § 501(c)(3) by reason of attempting to influence legislation, and which does not participate in, or intervene in, any political campaign on behalf of (or in opposition to) any candidate for public office.

Section 2055(e)(1) provides that no deduction shall be allowed under § 2055 for a transfer to or for the use of an organization or trust described in § 508(d) or § 4948(c)(4) subject to the conditions specified in such sections.

Section 501(c)(3) of the Code exempts from federal income tax organizations organized and operated exclusively for charitable purposes. Section 501(c)(3) organizations include corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition, and for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation, and which does not participate in, or intervene in, any political campaign on behalf of (or in opposition to) any candidate for public office.

Section 508(a) provides generally that an organization organized after October 9, 1969, shall not be treated as described in § 501(c)(3) –

(1) unless it has given notice to the Secretary, in such manner as the Secretary may by regulations prescribe, that it is applying for recognition of such status, or

(2) for any period before the giving of such notice, if such notice is given after the time prescribed.

Section 1.508-1(a)(2) of the Income Tax Regulations provides generally that an organization seeking exemption under § 501(c)(3) must file a Form 1023 exemption application within 15 months from the end of the month in which the organization was organized. (Rev. Proc. 92-85, 1992-2 C.B. 490 and § 301.9100-2 of the regulations extends the deadline by an additional 12 months). Such notice is filed by submitting a properly completed and executed Application for Recognition of Exemption, Form 1023, with the Internal Revenue Service.

Section 508(d)(2) provides that no gift or bequest made to an organization shall be allowed as a deduction under section 170, 545(b)(2), 556(b)(2), 642(c), 2055, 2106(a)(2), or 2522, if such gift or bequest is made–

(A) to a private foundation or trust described in § 4947 in a taxable year for which it fails to meet the requirements of § 508(e) (determined without regard to subsection (e)(2)), or

(B) to any organization in a period for which it is not treated as an organization described in § 501(c)(3) by reason of § 508(a).

Section 508(e)(1) provides that a private foundation shall not be exempt from taxation under § 501(a) unless its governing instrument includes provisions the effects of which are–

(A) to require its income for each taxable year to be distributed at such time and in such manner as not to subject the foundation to tax under § 4942, and

(B) to prohibit the foundation from engaging in any act of self-dealing (as defined in § 4941(d)), from retaining any excess business holdings (as defined in § 4943(c)), from making any investments in such manner as to subject the foundation to tax under § 4944, and from making any taxable expenditures (as defined in § 4945(d)).

Section 1.508-3(g)(1)(i) provides that except as provided in § 1.508-3(g)(2), § 508(e)(1) shall not apply to any private foundation (regardless of when organized) with respect to any taxable year beginning before the transitional date.

Section 1.508-3(g)(2) provides that § 1.508-3(g)(1) shall apply only to gifts or bequests referred to in § 508(d)(2)(A) that are made before the transitional date.

Section 1.508-3(g)(3) of the regulations provides that the term "transitional date" means the earlier of the following dates:

(i) in the case of a medical research organization, May 21, 1976, or in the case of a community trust February 10, 1977, or

(ii) the 91st day after the date an organization receives a final ruling or determination letter that it is a private foundation under § 509(e).

Section 4948(b) provides that § 507, § 508 and Chapter 42A shall not apply to any foreign organization which has received substantially all of its support (other than gross investment income) from sources outside the United States.

In this case, Decedent who was a citizen of the United States established Foundation in Country. Decedent made transfers to the Foundation during his lifetime and, under the terms of his Will, the residue of his estate is to pass to Foundation. All of Foundation's support came from Decedent.

The availability of charitable deductions with respect to taxes imposed by the Code is generally subject to the requirements of either § 508(d) or § 4948(c)(4) of the Code. Since Foundation has received more than 15% of its support (other than gross investment income) from a United States person (Decedent), it is not described in § 4948(b), and thus is subject to § 508(d).

Section 508(d)(2)(B) disallows a charitable deduction to any organization in a period for which it is not treated as described in § 501(c)(3) by reason of § 508(a). However, on Date 7, the Service issued a ruling letter granting Foundation relief under § 301.9100-3 of the regulations from the filing deadline imposed by § 508 of the Code, and recognizing Foundation's exemption under § 501(c)(3) as a private foundation. Under that ruling letter, Foundation's exemption under § 501(c)(3) is effective beginning on the date that Foundation was organized. Therefore, § 508(d)(2)(B) does not apply to disallow a charitable deduction.

Section 508(d)(2)(A) disallows a deduction for a gift to a private foundation in a taxable year for which it fails to meet the requirements of § 508(e). However, § 1.508-3(g)(1) and (2) provide that § 508(e)(1) shall not apply to any private foundation (regardless of when organized) with respect to any taxable year beginning before the transitional date. Section 1.508-3(g)(3) defines the transitional date as the 91st day after the date an organization receives a final ruling or determination letter that it is a private foundation under § 509(a), for organizations that are not community trusts or medical research organizations. Because Foundation met the governing instrument

requirements of § 508(e) before it received a ruling letter that it is a private foundation, § 508(d)(2)(A) does not disallow a charitable deduction. Therefore, § 508(d) will not bar the deductibility of Decedent's bequest to Foundation. Under these circumstances, we conclude that Decedent's bequest was made to an organization meeting the requirements of § 2055(a)(2). Accordingly, the residuary bequest to Foundation will qualify for the estate tax charitable deduction under § 2055(a).

ISSUE 2:

Section 2001(b) provides that the tentative estate tax is computed on the sum of– (A) the amount of the taxable estate, and (B) the amount of the adjusted taxable gifts, over the aggregate amount of tax which would have been payable under Chapter 12 of the Code. For purposes of § 2001(b)(1)(B), the term "adjusted taxable gifts" means the total amount of the taxable gifts (within the meaning of § 2503) made by the decedent after December 31, 1976, other than gifts which are includible in the gross estate of the decedent.

Section 2503(a) provides that the term "taxable gifts" means the total amount of gifts made during the calendar year, less the deductions provided in subchapter C (section 2522 and following).

Section 2501(a)(1) imposes a tax for each calendar year on the transfer of property by gift during such calendar year by any individual, resident or nonresident.

Section 2511(a) generally provides that the tax imposed by § 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 25.2511-1(h) of the Gift Tax Regulations provides examples of transactions resulting in taxable gifts. Section 25.2511-1(h)(1) provides, in part, that a transfer of property by an individual to a corporation is a gift by the individual to the individual shareholders of the corporation to the extent of their proportionate interests in the corporation. However, the section further provides that a transfer made by an individual to a charitable, public, political or similar organization may constitute a gift to the organization as a single entity depending on the facts and circumstances in the particular case.

Section 2522(a)(2) provides that in computing taxable gifts for the calendar year, there shall be allowed as a deduction in the case of a citizen or resident the amount of all gifts made during such year to or for the use of a corporation or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), including the encouragement of art and the prevention of

cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, which is not disqualified for tax exemption under § 501(c)(3) by reason of attempting to influence legislation, and which does not participate in, or intervene in, any political campaign on behalf of (or in opposition to) any candidate for public office.

In this case, Decedent made transfers in the amount of $a during his lifetime. Foundation's governing instrument indicates that Foundation's exclusive purpose is to provide scholarships to art students. There is no indication that the directors benefitted from the transfers. Furthermore, on Date 7, the Service issued a ruling letter recognizing Foundation's exemption under § 501(c)(3) as a private foundation. Under that ruling letter, Foundation's exemption under § 501(c)(3) is effective beginning on the date that Foundation was organized. The transfer of funds to Foundation made by Decedent during his life constituted gifts to Foundation as a single entity. Under these circumstances, we conclude that the transfers qualify for a deduction under § 2522(a)(2) and thus are not "taxable gifts" under § 2503(a) and, therefore, do not constitute "adjusted taxable gifts" under § 2001.

ISSUE 3:

Section 642(c)(1) of the Code provides that in the case of an estate or trust (other than a trust meeting the specifications of subpart B), there shall be allowed as a deduction in computing its taxable income (in lieu of the deduction allowed by § 170(a), relating to deduction for charitable, etc., contributions and gifts) any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, paid for a purpose specified in § 170(c) (determined without regard to § 170(c)(2)(A)).

Purposes specified in § 170(c), determined without regard to § 170(c)(2)(A), include a contribution or gift to or for the use of a corporation, trust, community chest, fund, or foundation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals; no part of the net earnings of which inures to the benefit of any private shareholder or individual; and which is not disqualified for tax exemption under § 501(c)(3) by reason of attempting to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

Income from the residue of an estate is considered to be part of a residuary bequest for purposes of the charitable deduction under § 642(c). See Rev. Rul. 57-133, 1957-1 C.B. 200.

Section 1.642(c)-3(e) of the Income Tax Regulations provides for a disallowance of deductions otherwise allowable under § 642(c)(1), (2), or (3) in cases where §§ 508(d) and 4948(c)(4) apply.

As concluded above, neither § 508(d) nor § 4948(c)(4) apply to disallow any deduction otherwise allowable under § 642(c). Under these facts and circumstances, we conclude the distributions to Foundation by Decedent's estate were paid pursuant to the governing instrument of the estate and are for a purpose specified in § 170(c), determined without regard to § 170(c)(2)(A). Accordingly, Decedent's estate may deduct the amounts paid to Foundation in Year 2 and Year 3 under § 642(c)(1), to the extent those amounts came from the gross income of the estate.

CAVEAT(S)

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.